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FILED
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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 517

WALTER M. HORT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WALTER J. ROSSTON,
Counsel for Petitioner.

EDWIN HORT,
Of Counsel.

THE COURT PRESS, N. Y. C.

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Section 240(a) 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No.

WALTER M. HORT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit.

Petitioner respectfully prays that a writ of certiorari issue to review the decision of the Circuit Court of Appeals for the Second Circuit, affirming a determination of the United States Board of Tax Appeals assessing an income tax deficiency of $38,070.71 in the personal income tax of the petitioner.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals is reported in 39 B. T. A. 922. The opinion of the Circuit Court of Appeals is unreported and is as follows, "affirmed on authority of *Warren Service Corp.* v. *Helvering,* 110 Fed. (2) 723".

JURISDICTION.

The decision of the Circuit Court of Appeals was entered on the 27th day of May, 1940. The peti-

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(Figures in parentheses refer to pages of record in Circuit Court of Appeals.)

tioner's time within which to file this petition was extended sixty days by an order of this Court made on August 24th, 1940. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

First: In computing net gain or loss for income tax purposes can a taxpayer upon the cancellation of a long term lease of great value to him as the lessor, offset the loss of the value of the lease cancelled against the consideration received by him for the cancellation. (In this case the Circuit Court of Appeals, Second Circuit, has held that such offset is improper, the Circuit Court of Appeals, Seventh Circuit, to the contrary, notwithstanding.)

Second: Where a taxpayer's petition for review by the Board of Tax Appeals sets forth two theories of tax computation, and the Circuit Court of Appeals disallows the theory urged by the petitioner, has not the Circuit Court of Appeals the power to remand the case to the United States Board of Tax Appeals for a re-hearing to permit the taxpayer to establish the other theory which in good faith and for good cause he did not develop before the Board of Tax Appeals upon the original hearing, especially if grave injustice may be done if such re-hearing is not allowed?

Statement of Facts.

On March 7, 1928 the petitioner inherited from his father the premises 76 Madison Avenue, New York City, a business building, the ground floor and base-

ment of which, at that time, was occupied for banking purposes by Irving Trust Company of New York, a very substantial and financially responsible banking institution. The Bank was a tenant of said premises under a lease which was to expire on January 31, 1932 (Stipulation of Facts, p. 35). In order to assure that at the expiration of its lease the Bank could continue in uninterrupted possession of the demised premises, the Bank entered into a lease of the same premises with petitioner's father in 1927 for a term of fifteen years, to commence February 1st, 1932 upon the expiration of the prior lease. The rental under the new lease was $25,000 per annum (Stipulation of Facts, p. 35).

In December 1933, at a time when the unexpired term of said new lease was thirteen years and two months, the petitioner as landlord and the Bank as tenant, by mutual consent, cancelled said new lease thus entirely releasing the Bank as tenant from any further obligation to pay rent for the unexpired term (Petitioner's Exhibit 5, Annexed to Stipulation of Facts, p. 38). The amount of such rental for the unexpired term, at the rate of $25,000 per annum, totaled $329,166.67 to which sum the petitioner, by such cancellation, relinquished all claim.

As a consideration for such cancellation, the Bank paid to the petitioner at the time of the cancellation $140,000 in cash (p. 38).

The full amount of this $140,000 the Commissioner contends is income for the calendar year 1933, in which year it was received by the petitioner.

The petitioner contends, upon the facts appearing uncontradicted in the record, that instead of income or gain of any kind to the petitioner, the transaction resulted in an actual loss to the petitioner in a substantial sum; or, in any event, that if the transaction

did not actually result in a loss it at least resulted in no income or gain of any kind to the petitioner.

The question involved is purely one of law, as the facts upon which the petitioner bases his claim of loss are wholly uncontradicted.

The petitioner could not have negotiated another lease, with a responsible party, for the unexpired term of the cancelled lease, for a rental equal to the rental provided for the unexpired term of the cancelled lease.

The only new leases which could be negotiated were for a rental so small that the amount of such re-rentals obtainable for the full unexpired term of the cancelled lease, plus the $140,000 received upon the cancellation, was less than the original rental of $25,000 per annum (pp. 46-47, 50, 51, 52, 56). The best offers actually obtainable, as well as expert opinions as to the rental value of the premises for the whole unexpired term, and the rentals actually obtained on the re-rental of the premises, covering the period of five years after the cancellation (pp. 51-52) clearly proved this. The respondent offered no proof to the contrary and apparently rested upon the question of law raised by him.

It appeared that subsequent to the cancellation of the lease the petitioner lost the real property by foreclosure of the mortgage. That there was no surplus money (p. 60), thus establishing that the possibility of recoupment of his loss by the petitioner's re-renting of the premises was destroyed.

It further appeared that the lease in question was in existence at the time the petitioner inherited the property and that at that time the market value of the property as it then existed, with said lease thereon, was appraised for estate tax purposes, and that such

taxes were computed and paid upon such appraisal of $650,000 (p. 36).

It further appeared that following the cancellation which occurred in December 1933 a receiver in a foreclosure action took possession of the property about three months thereafter, in March 1934, and that the petitioner never again had possession of the premises.

The petition for review filed with the United States Board of Tax Appeals set forth two grounds for a reversal of the determination of the Commissioner of Internal Revenue:

First, the refusal of the Commissioner to allow as an offset against the cash consideration received on the cancellation of the lease the value of the lease cancelled, measured by the difference between the rent reserved in the lease for the unexpired term of the lease, and the actual rental obtainable for such unexpired term, and

Second, the right of the petitioner to offset against such cash receipt the loss of the value of the real property itself through mortgage foreclosure closely following the cancellation, which foreclosure was caused by the failure of the income of the property, because of the cancellation, to pay the expenses of the operation of the real property and the mortgage obligations.

Upon the hearing before the Board of Tax Appeals, only the grounds referred to under First were proven; the grounds under Second were proven in part to the extent that it was shown that the real property was lost by foreclosure, as alleged in the petition, but the cause of the loss, that is, the in-

sufficiency of the income, was not attempted to be proven. The reason for this was that the petitioner relied upon the sufficiency of ground First, all of the proven facts of which were uncontradicted by the respondent, and the decision of the Circuit Court of Appeals, Seventh Circuit, in the case of *Commissioner of Internal Revenue* v. *Langwell Real Estate Corporation,* 47 Fed. (2) 841, which was apparently the sole and controlling authority upholding the sufficiency of ground First.

The Board of Tax Appeals in its decision, however, did not follow the *Langwell* case, and upon appeal by the petitioner to the Circuit Court of Appeals, Second Circuit, the determination of the Board was affirmed, thus creating a conflict between the decisions of the Second and the Seventh Circuits.

Upon the argument of the appeal a discussion of ground Second was had and it appeared that upon a re-hearing the petitioner might prove, if given the opportunity, that the loss of the property through foreclosure occurred during the taxable year of 1933 because of the cancellation of the lease in that year, and that the loss of the property through foreclosure in 1935, when the foreclosure sale finally occurred, was not the sole criterion of when the loss occurred. That there might be good grounds in justice and equity for allowing the loss of the property to be deducted during the year of the cancellation as an offset to the cash consideration received for the cancellation, but that the Circuit Court of Appeals might not have the power to remand for a re-hearing. Briefs were requested by the Circuit Court of Appeals on the question of the Court's power to remand, and such briefs were submitted but the Court of Appeals affirmed the Board of Tax Appeals without remanding.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In affirming the decision of the United States Board of Tax Appeals.

(2) In refusing to permit the petitioner to deduct or offset from said $140,000. the amount of loss sustained by him arising from the cancellation of the lease.

(3) In failing to remand the case to the United States Board of Tax Appeals for a re-hearing upon the alternate theory set forth in the petition of the petitioner to the United States Board of Tax Appeals, to wit, that the petitioner suffered the loss of his equity in the property by the foreclosure of a mortgage upon the property, which foreclosure resulted from the cancellation of the lease, and that the petitioner be permitted to offset such loss against the amount of the consideration received by him for the cancellation of the lease.

Reasons for Granting the Writ.

1. The Circuit Court of Appeals of the Second Circuit has rendered a decision in this case in apparent conflict with the decision of the Circuit Court of Appeals, Seventh Circuit, on the same matter, to wit, *Commissioner of Internal Revenue* v. *Langwell Real Estate Corp.*, 47 Fed. (2) 841. Said conflicting decisions were rendered upon the point as to whether or not for income tax purposes, a taxpayer upon the cancellation of a lease under which he is the lessor, can offset the value of the lease cancelled against the consideration received by him for the cancellation. The Circuit Court of Appeals, Second Circuit, in this case has held that such a deduction may not

be made. The Circuit Court of Appeals, Seventh Circuit, has held in a similar case that such a deduction may be made.

That the decisions of the Courts of Appeal of these two Circuits are in conflict appears from the decision of the Second Circuit Court in this case which simply states that there is an affirmance upon the authority of its own decision rendered shortly prior in the case of *Warren Service Corp.* v. *Commissioner,* 110 Fed. (2) 723. In the *Warren Service Corp.* case, which also involved the right of offset of the value of a cancelled lease against the consideration received for the cancellation, the Appeal Court, Second Circuit, stated in its opinion "If the case of *Commissioner* v. *Langwell Real Estate Corp.,* 47 Fed. (2) 841 (C. C. A. 7) is to be read as supporting the taxpayer's contention we must respectfully decline to follow it, as did the Board."

There is thus presented an express refusal to follow an earlier decision on the same matter by an Appeal Court of another Circuit and a clear conflict between the Appeal Courts of the two Circuits results.

2. The Circuit Court of Appeals, Second Circuit, has apparently refused to remand this case to the United States Board of Tax Appeals for a re-hearing, which might avoid a grave injustice to the taxpayer and has apparently refused to remand upon the ground that it lacks the power.

Upon this point there appears also to be a conflict of decisions between the Circuit Court of Appeals, Second Circuit, in this case, and the Circuit Court of Appeals of the Fifth, Seventh and the Ninth Circuits, all of which latter Courts have remanded cases to the United States Board of Tax Appeals for a re-hearing when justice required.

The decision of the Circuit Court of Appeals, Second Circuit, in this case, is in such form that it is not clear whether the Court refused to remand because of lack of power or because this was not a proper case to be remanded; however, the supplemental briefs which were filed were requested by the Court, upon the argument of the appeal, upon the question of the power of the Court to remand.

3. If there be any doubt as to the power of a Circuit Court of Appeals to remand a case to the United States Board of Tax Appeals for a re-hearing when justice requires it, then this case presents for review an important question of federal law which has not been but should be settled by this Court.

4. If a Circuit Court of Appeals has power to remand a case to the United States Board of Tax Appeals for a re-hearing where justice requires, is not the refusal to remand in this case a miscarriage of justice where the taxpayer has not fully presented his case to the United States Board of Tax Appeals because of proper reliance in good faith upon a Circuit Court of Appeals decision which at the time was the controlling authority of the case?

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

Walter J. Rosston,
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BRIEF IN SUPPORT OF PETITION.

POINT I.

There is clearly a conflict in the decisions of the Circuit Courts of Appeal on the question of the right of a taxpayer, for income tax purposes, to deduct the value of a lease lost through cancellation from the amount of consideration received by the taxpayer for the cancellation.

The identical question decided in the case at bar arose in 1931 in the Circuit Court of Appeals, Seventh Circuit,

> *Commissioner of Internal Revenue* v. *Langwell Real Estate Corporation,* 47 Fed. (2) 841 (Seventh Circuit)

and apparently the decision in that case was the highest authority on the point until the Circuit Court of Appeals, Second Circuit in the case at bar declined to follow it in *Warren Service Corp.* v. *Commissioner,* 110 Fed. (2) 723.

In the *Langwell* case, *supra,* a long term lease was cancelled by mutual consent of the lessee and of the taxpayer who was the owner of the premises by deed from the original lessor. (We shall refer to the transferee as the lessor.) At the time of the cancellation, the lessor held $50,000 of the lessee as security for the faithful performance by the lessee of the terms of the lease, said sum to be returned to the lessee at the expiration of the term, with interest. As the consideration for the cancellation it was agreed between the lessor and lessee, that the lessor keep the $50,000.

It was held by the Circuit Court of Appeals that the lessor was enriched in said sum, unless it appeared that the lessor "suffered a loss by reason of the termination of the lease." The sole test laid down by the Court for determining whether a loss was suffered is in the words of the Court:

> "If respondent could have readily negotiated another lease with a responsible party, as favorable as the lease which was cancelled, it suffered no loss. On the other hand, if it could not have negotiated such a lease, then it suffered a loss. The amount of such loss, if any, was the legitimate subject of proof. The actual execution of a new lease was not necessary to the determination of this issue. The rental value of such property could be shown by oral testimony."

The *Langwell* case is factually similar to the case on appeal so far as concerns the cancellation of the lease and the consideration therefor.

In the *Langwell* case the matter was sent back by the Circuit Court to the Board of Tax Appeals for rehearing on the issue of loss. The Board found on the rehearing that the lessor had not suffered any loss on the evidence presented. (30 B. T. A. 145.)

No attempt will be made in this brief to review the evidence submitted on the hearing on the present appeal before the Tax Board as no attempt was made by the respondent to contradict the convincing evidence presented by the petitioner, that the premises could not be as favorably relet after the cancellation as they had been under the terms of the cancelled lease. The respondent has not questioned the sufficiency of this proof, but apparently claims that the principle laid down by the *Langwell* decision is erroneous and should not be followed.

The petitioner rested upon the precedent of the *Langwell* case.

In the *Warren Service Corporation* case, referred to above there was likewise a cancellation of a long term lease by mutual consent of the owner and the lessee for a large cash consideration or the equivalent of cash paid by the lessee to the owner. Proof was given that the premises could not be relet upon as favorable terms as the former lease.

In deciding that there could be no offset in that case and that the decision in the *Langwell* case *supra* should not be followed, the Court stated in its opinion:

> "Assuming arguendo that this be true, the taxpayer contends that it sustained a loss by reason of the cancellation of the lease which more than offsets such income. It urges that it surrendered a contractual right to receive annual rentals far in excess of any sum for which it has been able to relet the premises. But this does not establish a deductible loss in 1933; it shows merely a diminution of expected income during that year and subsequent years. The taxpayer has sustained no loss of property in the income-tax sense. The land and building were and still are owned by the taxpayer and they have produced income. The difference between the income actually received and the income the taxpayer had expected to receive is not a deductible loss. What has been lost is merely prospective income. See *Josey* v. *Commissioner,* 104 F. (2d) 453, 455 (C. C. A. 10). If the case of *Commissioner* v. *Langwell Real Estate Corp.,* 47 F. (2d) 841 (C. C. A. 7) is to be read as supporting the taxpayer's contention, we must respectfully decline to follow it, as did the Board."

The *Josey* case mentioned in the foregoing opinion, although presenting a somewhat similar situation, does not actually decide the point in question, partly because there was lack of proof of all the elements necessary to claim a deduction and further, because the taxpayer had apparently claimed and actually been allowed a deduction in the nature of amortization over the balance of the term of the lease and was, therefore, claiming a double deduction. Furthermore, the decision does not even mention the *Langwell* case *supra.*

Insofar as the fact that title to the real property was still in the taxpayer may have been a reason for the refusal of the Second Circuit Court in the *Warren Service Corporation* case *supra,* to follow the *Langwell* rule, it should be noted that in the *Langwell* case it did not appear that the taxpayer had lost the real property by sale or otherwise. Apparently the Circuit Court of Appeals in the *Langwell* case did not consider this of any moment in reaching its decision. However, in the case at bar it should be noted that the taxpayer did lose the real property by foreclosure so that all possibility of recoupment was lost. Thus the case at bar presents a much stronger case for the taxpayer than the *Warren Service Corp.* case *supra.*

Between the time of the cancellation of the lease and the loss of the real property by foreclosure the record shows that the demised premises were not rerented. The Receiver in the foreclosure proceedings was appointed on March 16, 1934. The foreclosure sale was in 1935 (p. 60). The formerly demised premises were not relet even in part until March 1st, 1937, by the successor in title (p. 51).

Thus all speculation as to the possibility of recoupment of the taxpayer is wholly avoided. There was no recoupment and none is possible.

It has been recently held by the Circuit Court of Appeals that the fact that the taxpayer continues to hold title to real property does not necessarily deprive him of the right to claim that he has lost the value of the property.

Rhodes v. *Commissioner of Internal Revenue*, 100 Fed. (2nd) 966, Sixth Circuit.

It clearly appears that there is a conflict in the decisions of the Circuit Courts of Appeal on the subject in question which requires review and determination by this Court.

The question of the tax rule to be applied in cases of the cancellation of valuable leases is arising more and more frequently. The amount of taxes involved in such controversies is frequently substantial and a fixed ruling upon the subject appears to be necessary in order to remove the uncertainty as to whether or not such transactions are subject to taxation for the entire amount received without the right to deduct the amount of the concurrent loss.

POINT II.

Even if the Circuit Court of Appeals in this case properly affirmed the decision of the United States Board of Tax Appeals, the case should have been remanded for a rehearing by the Board to take proof on the alternate theory of the case in order to avoid an injustice, and clearly the Court of Appeals was in error if it held that it had no power to remand, and any such decision of lack of power is in conflict with the decisions of Courts of Appeal in other Circuits.

It is pointed out in the petition herein that there was an alternate theory of tax computation claimed by the taxpayer on his petition for review by the Tax Board but that no attempt was made to sustain the theory before the Tax Board. The theory based upon the *Langwell* case *supra* appeared sound and the facts were not disputed.

It is also pointed out in the petition herein that upon the argument of the appeal before the Circuit Court of Appeals the question of the power of the Circuit Court to remand the case to the Tax Board to take proof upon the alternate theory was raised, and supplemental briefs were requested by the Court on this point, and were submitted.

The affirmance by the Circuit Court without mention of remand would indicate that either the Circuit Court determined that it had not the power to remand, or that this was not a proper case to be remanded. It would appear that whichever determination was reached the decision is one which should be reviewed by this Court for the following reason:

If the Circuit Court decided that it had no power to remand then such decision is in conflict with de-

cisions rendered in the Fifth, Seventh and Ninth Circuits in the following cases in which the power to remand was exercised to take additional proof in order that a full and fair determination could be made of the entire matter.

In the Seventh Circuit the *Langwell* case *supra* was remanded for the purpose of taking proof on the question of the difference between the rental provided by the term of the cancelled lease for the remainder of the original term and the re-rental value of the premises for a like period in order to permit an offset similar to the one claimed in the case at bar.

In

Alger-Sullivan Lumber Co. v. *Commissioner,* 57 Fed. (2) 3 (Fifth Circuit)

the following was decided:

> "The judgment of the Board is reversed and the cause is remanded for further proceedings not inconsistent with this opinion."

It would further appear that without actually reversing the Board it is proper to remand the case, with instructions such as the following given in the case of

Belridge Oil Co. v. *Helvering,* 69 Fed. (2) 432 (Ninth Circuit).

> "The case is remanded to the Board of Tax Appeals with instructions to specifically find the actual value of the option in question."

In

Eaton v. *Commissioner,* 81 Fed. (2) 332 (Ninth Circuit)

the case was "remanded to the Board of Tax Appeals for a specific finding on the question * * *"

In

Fulton Oil Co. v. *Commissioner*, 81 Fed. (2) 330 (Ninth Circuit)

the Circuit Court found that a matter which was not raised before the Board of Tax Appeals should be the subject of a re-hearing in the following words:

> "We must remand the case to the Board of Tax Appeals for a finding as to whether there was a sale and consequent deductible loss." (Citing cases.)

This case may well be considered one in which there is an absence of a finding on a question which may be material to a full and just disposition of the case, to wit, the absence of any finding upon the issue raised by paragraph 5 W of the petition (fol. 27) that the cancellation of the lease in question was the direct and immediate cause of the foreclosure and loss of the petitioner's equity in the property, or it may be considered that there is an incomplete and unsatisfactory finding on this subject, to wit, the finding of the Board (at fol. 64) reading as follows:

> "The petitioner lost the property through foreclosure in 1935."

as well as the conclusion reached by the Board in its opinion apparently based upon such finding, reading as follows (fol. 73):

> "But he did not dispose of that property, and he sustained no loss in regard to it. Thus, even if on some theory the petitioner might be entitled to a loss, nevertheless, he has failed to prove that in fact any loss was sustained."

The petitioner should be given an opportunity to prove any loss of equity in the property itself which he may have suffered by reason of the foreclosure of the mortgage resulting from the cancellation of the lease, as alleged in the petition to the Tax Board.

CONCLUSION.

Because of the apparent conflict in the decisions of the Second and Seventh Circuit Courts of Appeal on the important question of the right of a taxpayer to offset the loss sustained by the cancellation of a valuable lease against the consideration received by him for the cancellation, this case should be reviewed by this Court. Furthermore, if the Langwell decision in the Seventh Circuit is no longer to be considered as good law, then justice requires that the case be remanded to the United States Board of Tax Appeals for a re-hearing on the alternate theory of loss pleaded in the taxpayer petition to the Board; and if there is any doubt as to the power of a Circuit Court of Appeals to remand a case to the Tax Board, then a grave question of the power of the Circuit Courts of Appeal arises which should be reviewed by this Court.

Respectfully submitted,

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